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RUEHSO/AMCONSUL SAO PAULO 7087
RUEHBU/AMEMBASSY BUENOS AIRES 4064
RUEHAC/AMEMBASSY ASUNCION 5479
RUEHMN/AMEMBASSY MONTEVIDEO 6293
RUEHSG/AMEMBASSY SANTIAGO 5553
RUEHPE/AMEMBASSY LIMA 3031
RUEHCV/AMEMBASSY CARACAS 3286
RUEHQT/AMEMBASSY QUITO 1859
RUEHLP/AMEMBASSY LA PAZ 4632
RUEHBO/AMEMBASSY BOGOTA 3788
RHEHNSC/NSC WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RHEBAAA/DEPT OF ENERGY WASHDC
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TAGS: [EPET](#) [ENRG](#) [EINV](#) [ECON](#) [PGOV](#) [CH](#) [BR](#) [BO](#)
SUBJECT: PETROBRAS' CAREFUL STEPS

REFS: A) BRASILIA 1017

B) BRASILIA 1029
C) LA PAZ 1407

11. (SBU) Summary: In a May 26 meeting Petrobras Director of International Affairs Nestor Cervero told the Charge, CG and econoff that three issues occupy most of the discussion in ongoing negotiations with Bolivia -- the degree to which the Bolivian government will increase well-head taxes, how the Bolivian government intends to pay for the 50 percent plus one share stake that YPFB wants in Petrobras' Bolivian operations, and Bolivia's "unacceptable" proposal for a unilateral price increase. Cervero said the company hopes to reach a negotiated agreement within the 6-month time period allotted by the Bolivian authorities (i.e., by mid-November). Petrobras is forging ahead with plans to: a) build two re-gasification plants to allow Liquid Natural Gas (LNG) imports, and b) speed development of its own offshore gas resources.

These efforts to increase Brazilian access to alternative sources of gas, Cervero declared, mean that whatever the outcome of the negotiations with Bolivia, that country will not be able to increase the amount of gas it exports to Brazil. In Ecuador, Petrobras has no intention of taking over Occidental Petroleum's assets, Cervero said, despite media reports claiming the company was interested. To do so would be bad business, he commented. On the R&D side, Petrobras has successfully tested a soybean oil and diesel fuel mix that it intends to use at all of its refineries. With deals moving forward in Asia, Latin America and Africa, Petrobras would like to further develop the biofuel technology industry. End Summary.

BOLIVIA

12. (SBU) Bolivian President Evo Morales has a problem, Cervero told Charge, Consul General, and Econoff. He needs USD one billion by year end for "budget support," without which, Morales could be

forced out of office before the end of his term, as have so many Bolivian presidents before him. Clearly, said Cervero, Morales hopes to raise 500 million from oil and gas company taxation and another 500 million from natural gas price increases. Knowing this, Petrobras does not take the increased taxes and proposed price hike personally, only the dramatic manner in which these demands were made. Having Bolivian military on the property with guns etc. is more than a bit uncomfortable, Cervero said.

13. (SBU) Cervero opined that while Petrobras was on weaker ground in fighting the 64 percent tax increase (from 50 to 82 percent at the well head), the company could and would refuse the unilateral price increase. When pressed, Cervero admitted that the company could still operate at the 82 percent tax rate. The Bolivian government has access to our pricing formula, so they did not pull the 82 percent figure out of thin air, he admitted.

14. (SBU) The non-starter for Petrobras was Bolivia unilaterally dictating a gas price increase of US\$2 to the current price of US\$3 per million British Thermal Units, or BTUs. Cervero stated that the price increase would have to be negotiated carefully, based on the guidelines laid out in the existing contract. His assessment was in line with what Banco Pactual Energy analyst Pedro Batista told econoffs in a prior May 22 meeting. Pactual predicts that the parties will settle on a price increase more along the lines of 70-75 cents instead of two dollars. (NOTE: Recent press reports state that the Bolivian government has proposed a much higher price, circa US\$3.40).

15. (SBU) Ultimately the negotiation between Petrobras (i.e. not the Brazilian government) and Bolivia will need to continue for the two to come to some sort of agreement. Cervero could not specify what that agreement would entail but noted that the parties are still

BRASILIA 00001094 002 OF 003

negotiating and will work hard to meet the mid-November deadline set by the Bolivian government. Cervero made clear that Petrobras is concerned about how Bolivia will compensate the company for the Yacimientos Petroliferos Fiscales Bolivianos (YPFB)'s desired 50 percent plus one share controlling stake in company operations in Bolivia. Petrobras is also concerned that Bolivia has not been paying its contractual obligations, i.e., the diesel fuel that Petrobras supplies to the country. (Note: May 31 press reports quoted YPFB spokesmen as calling the shortage of diesel in Bolivia an "act of sabotage" by Petrobras. For its part, in a June 1 press release Petrobras Bolivia stated it had halted imports because the Bolivian government had failed to pay the subsidy designed to keep Bolivian diesel prices below market prices.)

16. (SBU) When pressed about next steps in regarding the company's Bolivian assets, Cervero responded that Petrobras would invest no more money in Bolivia above minimum maintenance requirements and therefore would not expand the pipeline. Instead, the company will move forward on its two proposed LNG regasification sites in Rio de Janeiro and Ceara states. Petrobras' hope is to eventually replace Bolivian natural gas, but Cervero admitted that it will take some doing.

ECUADOR

17. (SBU) On the subject of Ecuador, Charge reiterated USG position on the expulsion of Occidental Petroleum and advised that other companies' involvement in the dispute would be unhelpful (ref b). Cervero responded that Petrobras will not take over Occidental Petroleum's recently nationalized assets. To do so, according to Cervero, would be bad business for Petrobras -- which has partnered with Occidental on a project in the U.S. Previously, Petrobras had faced the same sort of choice in the Sudan and had also declined to participate, citing a similar partnership arrangement. However, Cervero noted that the company fully intends to continue the other projects it has with the Ecuadorians.

VENEZUELA

¶8. (SBU) Cervero believes that Venezuelan President Chavez's proposal several months ago to purchase 36 petroleum platforms from Brazil is now off the table. Chavez has apparently decided that spending his petro-capital on China and Argentina would have a better political pay off than Brazil, Cervero continued. However, the USD 2.5 billion Petrobras/PDVSA refinery deal is still slated to be finished in 2011. Cervero further noted that Chavez also seems to be moving towards usurping Petrobras' place in Bolivia, as in meetings with Bolivian officials, members of the Venezuelan Petroleum parastatal, PDVSA, are often present, giving the Bolivians advice. As for the proposed 8000 km gas pipeline connecting Brazil, Venezuela, Argentina and possibly Bolivia, Cervero demurred, stating only that Petrobras is participating in the feasibility study.

RENEWABLES

¶9. (SBU) Petrobras is a leader in renewable energy technology, said Cervero. The company supports the initial phases of production of sugar cane-based ethanol in Venezuela, Argentina, Colombia, of cassava-based ethanol in Nigeria, and is negotiating agreements to develop cane-based production in Angola and South Africa. The choice of Africa is obvious to Petrobras as that continent possesses large tracts of land that can be put to use above subsistence level agriculture. Cervero highlighted the possibilities for renewable technologies to help turn around developing economies, in particular in places like Haiti. He said that Petrobras' agreement with Japan

BRASILIA 00001094 003 OF 003

is an export only deal, unlike the rest of its contracts in the renewables area. Cervero also noted that Petrobras had developed a new approach to biodiesel production whereby soybean oil is blended into diesel as part of the petroleum refining process, resulting in a biodiesel comprised of 18 percent of soybean oil. This biodiesel would reduce sulfur emissions and provide soy producers with an alternative to the Chinese export market. The company recently tested the 18 percent solution in three refineries and plans to extend its use to all Petrobras facilities.

COMMENT

¶10. (SBU) With Lula's Vienna conversation with Morales apparently having helped tone down, at least temporarily, Morales' and the Bolivian government's rhetoric on Petrobras (ref B), the action will shift more and more to the ongoing negotiations between Petrobras and Bolivia. As a publicly traded company, Petrobras has legal obligations to protect its shareholders and will be required forcefully to defend its interests, despite Lula's conciliatory public comments. The negotiations over the price of the gas, in particular, are shaping up to be contentious. On a parallel track, Cervero's comments confirm the view that, having been burnt, Petrobras and Brazil will systematically reduce their dependence on Bolivian gas over the next few years and will not undertake new investments in the country. From the Brazilian perspective, whatever the outcome of the negotiations, Bolivia's actions mean Brazil will refrain from investments designed to increase gas imports from Bolivia. What had been an energy relationship with potential for growth seems to have become stagnant, at best.

CHICOLA